Audit Report

OFFICE OF THE INSPECTOR GENERAL

SUMMARY REPORT ON THE FY 1994 FINANCIAL STATEMENT AUDITS OF DEFENSE AGENCIES

Report No. 97-008

October 25, 1996

Department of Defense

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Acronyms

BMDO	Ballistic Missile Defense Organization
CAFRMS	Centralized Accounting and Financial Resource Management System
CIM	Corporate Information Management
DARPA	Defense Advanced Research Projects Agency
DFAS DAO/WHS	Defense Finance and Accounting Service, Defense Accounting Office, Washington Headquarters Services
DISA	Defense Information Systems Agency
DMA	Defense Mapping Agency
DNA	Defense Nuclear Agency
KAR	Key Accounting Requirement
OASD(C^3I)	Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)
OCHAMPUS	Office of the Civilian Health and Medical Program of the Uniformed Services
WHS	Washington Headquarters Services

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MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Summary Report on the FY 1994 Financial Statement Audits of Defense Agencies (Project No. 5RF-6010.13)

Introduction

We are providing this summary report for information and use. The report summarizes accounting system weaknesses identified during our research project and audits of Defense agencies' FY 1994 financial statements.

In February 1995, we began the Research for Audits of Defense Agencies' Financial Statements to develop information to aid in prioritizing and supporting audits of Defense agencies' FY 1996 financial statements, which are required by the Chief Financial Officers Act (Public Law 101-576). As a result of the research project, we identified accounting system weaknesses for 18 Defense agencies. From June 1995 through July 1996, we issued 10 audit reports (see Enclosure 1) on accounting system weaknesses for 8 of the 18 Defense agencies. All the audit reports identify material weaknesses.

DoD 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, May 1993, provides specific DoD policies for evaluating accounting systems. The Regulation specifies 13 key accounting requirements (KARs) with which accounting systems must comply. The Regulation further states that a material noncompliance with a KAR requires corrective action within a reasonable period. The accounting requirements are a composite of requirements of the General Accounting Office, Office of Management and Budget, Department of the Treasury, and DoD. The KARs are summarized in Enclosure 2.

Audit Results

The audits and research performed at the 18 Defense agencies[1] showed that the majority of the accounting system weaknesses related to four KARs:

- o general ledger control and financial reporting (13 Defense agencies),

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[1]For the purposes of this report, the term Defense agencies includes DoD Field Activities.

o property and inventory accounting (8 Defense agencies),

o system controls (fund and internal) (9 Defense agencies), and

o audit trails (7 Defense agencies).

We also identified weaknesses related to three additional KARs: accrual accounting (three agencies), military and civilian payroll procedures (three agencies), and cost accounting (one agency).

As a result, general ledger account data at the Defense agencies are misstated and, if not corrected, the weaknesses that led to the discrepancies may adversely affect the reliability of financial statements.

Audit Objectives

Our report objective was to summarize the accounting system weaknesses identified during the research on and audits of Defense agencies' FY 1994 financial statements. Also, we summarized reviews of management control programs as applicable. Management control issues are discussed in Enclosure 3.

Scope and Methodology

We reviewed the documentation for Defense agencies' FY 1994 financial statements. The documentation consisted of 18 client profiles and 10 audit reports that were prepared from June 1995 through July 1996.

The client profiles documented issues that were identified as a result of general research, whereas the audit reports identified reportable conditions as a result of more extensive field work.

The following Defense agencies were included in the audit.

o American Forces Information Service
o Ballistic Missile Defense Organization[2,3]
o Corporate Information Management[2,3]
o Defense Advanced Research Projects Agency[2,3]
o Defense Contract Audit Agency

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[2]For a synopsis of the audit report issued for this Defense agency, see Enclosure 3.

[3]The audit report identified a material weakness.

- Defense Information Systems Agency[2,3,4]
- Defense Legal Services Agency
- Defense Logistics Agency
- Defense Mapping Agency[2,3,5]
- Defense Medical Programs Activity
- Defense Nuclear Agency[2,3,6]
- Defense Technology Security Administration
- Department of Defense Education Activity
- Joint Staff[2,3]
- Office of Civilian Health and Medical Program of the Uniformed Services
- On-Site Inspection Agency
- Uniformed Services University of the Health Sciences
- Washington Headquarters Services[2,3]

Limitations to Audit Scope. We did not review compliance with each of the 13 key accounting requirements at all 18 Defense agencies. The accounting system weaknesses documented in this report were identified as a result of research (client profiles) performed from an overview perspective on the Defense agencies' FY 1994 financial statements and from the 10 audit reports.

Audit Period and Standards. We performed this financial-related audit from February through May 1996 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. We did not rely on computer-processed data or statistical sampling procedures for this audit.

Prior Audits and Other Reviews

From June 1995 through July 1996, we issued 10 audit reports (see Enclosure 1) on Defense agencies' FY 1994 financial statements. One audit report identifies material management control deficiencies at the Defense Finance and Accounting Service, Denver Center, Defense Accounting Office, Washington Headquarters Services (DFAS DAO/WHS). The DFAS

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[2]For a synopsis of the audit report issued for this Defense agency, see Enclosure 3.

[3]The audit report identified a material weakness.

[4]Two audit reports have been issued for this Defense agency.

[5]Now the National Imagery and Mapping Agency. The report hereafter refers to the Defense Mapping Agency (or the DMA), the name of the agency at the time of the audit.

[6]Now the Defense Special Weapons Agency. The report hereafter refers to the Defense Nuclear Agency (or the DNA), the name of the agency at the time of the audit.

DAO/WHS performed the installation accounting function and/or the annual financial statement preparation function for several of the Defense agencies included in the scope of this summary report.

Audit Background

The Chief Financial Officers Act of 1990 (Public Law 101-576) established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, "Federal Financial Management Act of 1994," significantly expanded the audit requirements established in the Chief Financial Officers Act. The law requires the Inspectors General to audit consolidated financial statements covering all accounts and activities for FY 1996 and each succeeding year.

The DoD-wide financial statement includes a funds category entitled, "Other Defense Organizations." In support of the FY 1996 consolidated financial statement audit, we began the Research for Audits of Defense Agencies' Financial Statements and audited internal controls and compliance with financial regulations for those organizations included in the Other Defense Organizations category. Although we do not plan to render an audit opinion on "Other Defense Organizations," information gathered on the Defense agencies will be subject to analytical review in order to render an opinion on the overall DoD-wide financial statements.

Discussion

Under the Research for Audits of Defense Agencies' Financial Statements, we performed preliminary reviews of Defense agency financial and accounting systems to determine the Inspector General, DoD, audit approach. The research resulted in both long- and short-term objectives for the Inspector General, DoD, as they apply to audits of Defense agencies' financial statements.

The long-term audit objective is to perform audits of selected Defense agencies and to issue audit reports on internal controls and compliance with laws and regulations in support of rendering an opinion on the overall DoD-wide financial statements. Short-term audit objectives include evaluating the adequacy of management control programs and compliance with selected KARs. Audits of management control programs include evaluating the implementation of controls and the performance of annual accounting system reviews. Evaluating compliance with selected KARs includes evaluating compliance with KARs that have significant application to Defense agencies. Annual summary reports will be written to describe progress made to achieve both the long- and short-term objectives.

For the 18 Defense agencies, we identified material and other accounting system weaknesses related to seven KARs.

General Ledger Control and Financial Reporting (KAR 1). The KAR 1 states that an accounting system must have general ledger control and maintain a DoD approved general ledger account structure for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. In addition, full financial disclosure, accountability, adequate financial information, and reports must be provided for management purposes and for necessary external reporting to the Office of Management and Budget and the Department of the Treasury.

Material general ledger and financial reporting weaknesses existed at the accounting offices that support the Defense Advanced Research Projects Agency and the Defense Logistics Agency, and at the Defense Information Systems Agency and the Defense Nuclear Agency. For Corporate Information Management funds, we identified a material general ledger and financial reporting weakness, which was corrected during the audit. Other general ledger and financial reporting weaknesses existed at the accounting offices that support the American Forces Information Service, the Ballistic Missile Defense Organization, and the Joint Staff, and at the Defense Mapping Agency, the Department of Defense Education Activity, the Office of Civilian Health and Medical Program of the Uniformed Services, the On-Site Inspection Agency, and the Uniformed Services University of the Health Sciences. Generally, the Defense agencies or their supporting accounting offices did not use the DoD approved standard general ledger account structure to prepare FY 1994 general-purpose financial statements. Instead, the Defense agencies or their supporting accounting offices inappropriately used budget execution reports as the data source for the financial statements. Budget execution reports did not contain needed information to prepare complete and accurate FY 1994 financial statements. Accounting personnel used budget execution reports because accounting personnel had not been trained in understanding the relationship between the general ledger account structure and financial statements, and because the management control programs were not adequate to ensure that financial statements were prepared using proper sources of information. Details on the material and other weaknesses related to KAR 1 are in Enclosure 4.

Property and Inventory Accounting (KAR 2). The KAR 2 states that an accounting system must account, in quantitative and monetary terms, for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material. The property management system must include accounting controls over inventory ledgers that identify the item, its location, quantity, acquisition date, cost, and other information. Subsidiary property records should be reconciled periodically to general ledger control accounts.

Material property and inventory accounting weaknesses existed at the Defense Information Systems Agency, the Defense Logistics Agency, the Defense Mapping Agency, the Defense Nuclear Agency, the Department of Defense Education Activity, and the Washington Headquarters Services. Other property and inventory accounting weaknesses existed at the Defense Technology Security Administration and at the Office of Civilian Health and Medical Program of the Uniformed Services.

Material property and inventory accounting weaknesses occurred primarily because the Defense agencies did not analyze financial transactions needed to make appropriate accounting entries and because inventories of capital assets had not been reconciled to general ledger control accounts. As a result, property and inventory were often inappropriately expensed or capitalized,[7] and the affected general ledger accounts were significantly either overstated or understated. Details on the Defense agencies' material and other weaknesses related to KAR 2 are in Enclosure 5.

Cost Accounting Weaknesses (KAR 4) at the Defense Mapping Agency. The KAR 4 states that cost accounting must involve accounting analysis and reporting on costs of production of goods or services or operation of programs, activities, functions, or organizational units. Cost accounting shall be provided in the accounting system if it is required in such instances as pricing decisions, productivity decisions, or measurement of performance.

A material cost accounting weakness existed at the Defense Mapping Agency (DMA) in that unit costs of DMA products were incorrect and lacked supporting documentation. It was difficult for DMA to determine the cost of its products in inventory because DMA produces rather than purchases the majority of its products and did not have a cost accounting system for its products. The "DMA Product Cost and Pricing Manual," June 1987, provides detailed instructions on manually pricing DMA products. However, DMA did not use the procedures described in the manual because extensive information was needed for determining the cost of each item, and DMA did not consider the effort worth expending the necessary resources.

In August 1995, DMA decided to install an automated cost accounting system--the Job Order Cost Accounting System II. The Job Order Cost Accounting System II was scheduled for installation at DMA in the summer of FY 1996. The cost accounting system project officer at DMA expected the Job Order Cost Accounting System II to be fully operational about 1 year after installation at DMA. Once DMA has the Job Order Cost Accounting System II fully operational, DMA will have the capability to track and calculate direct and indirect costs for DMA products.

Accrual Accounting (KAR 5) and Military and Civilian Payroll Procedures (KAR 6). The KAR 5 states that accrual accounting must recognize the accountable aspects of financial transactions or events as they occur. Accrued expenses are expenses that have been incurred but not paid and must be reflected as a period expense in the financial statements. Transactions may either be recorded in accounting records as they occur or be adjusted to the accrual basis at the end of each month. The KAR 5 also states that unpaid personnel compensation and benefits that have been earned as of the end of the

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[7]Property purchased is "capitalized" when it is recorded as an asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense. (Current capitalization threshold is $100,000.)

pay year must be accrued in full or in part. Accrued payroll for civilian and military salaries and wages, unfunded annual leave, and annual leave must be recorded and reconciled with the actual payroll.

The KAR 6 states that payroll systems must incorporate controls of payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments. Unpaid personnel compensation and benefits, including annual leave, which have been earned by employees as of the end of the pay year, must be accrued in full. Personnel compensation and all employee benefit expenses shall be reported and disclosed in the financial statements.

Material weaknesses existed in accrual accounting and military and civilian payroll procedures at the Defense Information Systems Agency. Other weaknesses existed at the Defense Nuclear Agency and at the Office of Civilian Health and Medical Program of the Uniformed Services.

Defense Information Systems Agency. The FY 1994 Defense Information Systems Agency financial statements did not report liabilities of $12 million for annual leave benefits earned, but not paid to employees. The Defense Information Systems Agency also misclassified liabilities of about $3.3 million for payroll and related benefits earned, but not paid to employees.

Defense Nuclear Agency. The Defense Nuclear Agency had not established a liability for accrued unfunded annual leave payable. The auditors estimated that a $2 million liability for unfunded annual leave existed at the end of May 1995.

Office of Civilian Health and Medical Program of the Uniformed Services. The Office of Civilian Health and Medical Program of the Uniformed Services did not include the account Accrued Payables-Civilian-Salaries and Wages in the FY 1994 trial balance. At the end of the fiscal year, 2 weeks of payroll had accrued at the cost of about $461,000. The Office of Civilian Health and Medical Program of the Uniformed Services did not report this account because the Resource Accounting Management System does not allow for the accrual of those expenses and because accounting personnel do not manually adjust the account at the end of the fiscal year. Because of this omission, the financial statements were misstated and did not reflect the accurate financial position of the Office of Civilian Health and Medical Program of the Uniformed Services.

System Control (Fund and Internal) (KAR 7). The KAR 7 states that the accounting system must ensure that obligations and expenditures do not exceed the amount appropriated. The accounting system must provide a process and procedures for controlling errors. The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. The system must have good fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements. The accounting system must also have adequate internal controls to prevent, detect, and correct errors and irregularities that occur throughout the system.

Material system control weaknesses existed at the accounting offices that support the Ballistic Missile Defense Organization, the Defense Advanced Research Projects Agency, and the Joint Staff. Material system control weaknesses also existed at the Defense Information Systems Agency, the DMA, the Department of Defense Education Activity, and the Office of Civilian Health and Medical Program of the Uniformed Services. Other system control weaknesses existed at the Defense Contract Audit Agency, and the Uniformed Services University of the Health Sciences.

The Defense agencies or their supporting accounting offices, in general, did not provide supervision or a system of review needed to maintain control over the integrity of the FY 1994 financial statements. Also, the Defense agencies or their supporting accounting offices had not established effective accounting controls concerning the use and maintenance of general ledger accounts and the accuracy and classification of property transactions. The DFAS DAO/WHS prepared the FY 1994 financial statements for some of the Defense agencies audited and had no controls in place to ensure that personnel were properly trained to prepare financial statements. Details on the material and other weaknesses related to KAR 7 are in Enclosure 6.

Audit Trails (KAR 8). The KAR 8 states that the financial transactions on accounting system processes must be adequately supported with pertinent source documents. All transactions must be traceable to source records, and audit trails should allow a transaction to be traced from initiation through processing to final reports.

Material audit trail weaknesses existed at the accounting offices that support the Defense Advanced Research Projects Agency, the Defense Legal Services Agency, the Defense Medical Programs Activity, and the Joint Staff. Those material weaknesses also existed at the Department of Defense Education Activity. Other audit trail weaknesses existed in the accounting records at the American Forces Information Service and the Ballistic Missile Defense Organization.

In general, audit trail weaknesses existed in Defense agencies' accounting records as prepared by the DFAS DAO/WHS. Because the DFAS DAO/WHS did not properly maintain source documents and files, audit trails maintained by the DFAS DAO/WHS were deficient, and supporting documentation for transactions involving financial statement accounts could not be provided when requested. Details on the material and other weaknesses related to KAR 8 are in Enclosure 7.

Management Comments

Management has initiated actions in response to audit report recommendations to correct discrepancies that may adversely affect the reliability of financial statements. We provided a draft of this report to the addressees on August 29, 1996. Because this report contains no findings or recommendations, written comments were not required, and none were received.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529) or Ms. Deborah Carros, Audit Project Manager, at (703) 604-9539 (DSN 664-9539). Enclosure 8 lists the distribution of this report. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosures

Synopses of FY 1994 Financial Statement and Related Audit Reports

Inspector General, DoD, Report No. 96-194, "The Capitalization of Washington Headquarters Services Military Equipment, July 16, 1996. The report states that the Washington Headquarters Services (WHS) FY 1994 general ledger military equipment account, Equipment in Use, included the cost of office furniture, furnishings, and fixtures with unit costs that did not meet DoD capitalization criteria; contract services that were inappropriately classified as acquisition costs of equipment; and computer equipment with unit costs that did not meet DoD capitalization criteria. As a result, WHS overstated general ledger asset accounts and general ledger equity accounts by at least $16.3 million in FY 1994. The WHS initiated actions during the audit to remove from the Equipment in Use account $9.5 million that reflected office furniture, furnishings, and fixtures transactions with unit costs that did not meet capitalization criteria. WHS also corrected a flaw in the WHS Allotment Accounting System that inappropriately recorded equipment procured for other DoD organizations in the WHS military equipment account. The report recommends that WHS reduce the amount of its Equipment in Use account and its general ledger equity account by $6.8 million. The report also recommends that the WHS establish accounting controls to ensure that military equipment transactions are correctly capitalized and that WHS review past transactions and expense those costs that do not meet DoD capitalization criteria. The WHS had taken corrective actions that were considered responsive.

Inspector General, DoD, Report No. 96-155, "The Defense Information Systems Agency General Ledger Military Equipment Account," June 10, 1996. The report states that the Defense Information Systems Agency (DISA) general ledger asset account, Equipment in Use, was significantly overstated. The Equipment in Use account inappropriately included the acquisition cost of military equipment transferred to other DoD Components; military equipment loaned or furnished to other DoD Components, Federal agencies, and DoD contractors; computer software that should have been recorded in another asset account; and military equipment and other services that should have been expensed. The overstatements occurred because DISA did not analyze financial transactions needed to make appropriate accounting entries. In addition, DISA did not record in its official property records the military equipment loaned or furnished to other DoD Components, Federal agencies, and DoD contractors. As a result, DISA overstated military equipment in use by about $93.7 million and misstated general ledger accounts. The report recommends that DISA analyze military equipment transactions and make appropriate accounting entries to accurately record military equipment transactions in the DISA general ledger; record military equipment loaned and furnished to other DoD Components, Federal agencies, and contractors in the official DISA property book; and establish appropriate control techniques to ensure that military equipment transactions are accurately recorded in the general ledger and DISA property records. The DISA concurred with all recommendations and has initiated corrective actions.

Inspector General, DoD, Report No. 96-088, "Inventory at the Defense Mapping Agency," March 26, 1996. The report states that the physical count of DMA inventory differed from the quantities in accountable records, unit costs of DMA products were incorrect and lacked supporting documentation, and inventory on hand exceeded inventory usage history. As a result, about 83 percent of reported inventory balances at DMA Philadelphia was incorrect, accounting records could not be relied on to produce accurate financial statements, and DMA records showed that about 30 percent of the recorded inventory was excess to inventory stock level objectives. The report recommends that DMA perform a wall-to-wall inventory of DMA products and make appropriate adjustments to accountable records. The report also recommends that DMA value and report inventory based on historical costs, establish controls to assure that unit costs are supported and accurate, and identify excess inventory in financial reports. The DMA concurred with the recommendations and stated that controls and procedures either had been or would be established to correct each problem.

Inspector General, DoD, Report No. 96-083, "Accounting Support for Preparation of Joint Chiefs of Staff Financial Statements," March 12, 1996. The report states that the FY 1994 Joint Staff financial statements, prepared by the DFAS DAO/WHS, were inaccurate. The DFAS DAO/WHS reported Joint Staff Research, Development, Test, and Evaluation funds to the DFAS Indianapolis Center on two separate financial statements, resulting in an overstatement of Joint Staff assets of about $48 million. In addition, to determine the equity for the FY 1994 Joint Staff financial statements, the DFAS DAO/WHS calculated equity amounts using information from budget execution reports instead of using proprietary general ledger account information. The budget execution reports did not contain the information needed to prepare complete and accurate FY 1994 financial statements. No recommendations were made because recommendations in prior audit reports should remedy the deficiencies noted in the report.

Inspector General, DoD, Report No. 96-068, "Accounting Support for Preparation of Ballistic Missile Defense Organization Financial Statements," February 9, 1996. The report states that the FY 1994 financial statements prepared by the DFAS DAO/WHS were inaccurate and incomplete. The DFAS DAO/WHS reported Ballistic Missile Defense Organization (BMDO) Research, Development, Test, and Evaluation funds to the DFAS Indianapolis Center on two separate financial statements, resulting in overstatements of BMDO asset, liability, and equity accounts. In addition, the DFAS DAO/WHS used budgetary information from budget execution reports instead of using proprietary general ledger account information to prepare BMDO FY 1994 financial statements. Budget execution reports did not contain needed information to prepare complete and accurate FY 1994 financial statements. The report identified errors and omissions, totaling about $1.9 billion, in 12 financial statement accounts. No recommendations were made because recommendations in prior audit reports should remedy the deficiencies noted in the report.

Inspector General, DoD, Report No. 96-048, "Defense Accounting Office, Washington Headquarters Services, Procedures for Preparing FY 1994 Financial Statements for the Advanced Research Projects Agency," December 19, 1995. The report states that the DFAS DAO/WHS had not implemented DoD financial management directives and related guidance for preparing Advanced Research Projects Agency* financial statements. The DFAS DAO/WHS prepared consolidated financial statements for the Advanced Research Projects Agency using budget execution reports instead of proprietary trial balances. Consequently, the DFAS DAO/WHS prepared financial statements that overstated the Advanced Research Projects Agency financial position by $2.2 billion in assets, $25 million in liabilities, and $2.2 billion in equity. The report recommends that the DFAS DAO/WHS establish procedures to verify that Advanced Research Projects Agency financial statements for FY 1996 and subsequent years are accurately prepared in accordance with DoD Regulation 7000.14-R, volume 1, May 1993, and DoD Directive 7220.9-M, chapter 94, October 1983. In addition, the report recommends that DFAS train employees assigned to prepare general-purpose financial statements in how to prepare the statements properly and accurately. DFAS concurred in general with the recommendations and took corrective actions.

Inspector General, DoD, Report No. 96-042, "Corporate Information Management Financial Statements," December 11, 1995. The report states that the FY 1994 Corporate Information Management trial balance, prepared by the WHS, omitted Corporate Information Management funds that the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) suballocated to the DISA and to the Military Departments. However, the Office of the Assistant Secretary of Defense implemented management control procedures during the audit to assist in producing a complete Corporate Information Management trial balance and auditable Corporate Information Management financial statements. The report contains no findings or recommendations.

Inspector General, DoD, Report No. 96-039, Financial Accounting for the Defense Nuclear Agency," December 11, 1995. The report states that the financial accounting system used by Defense Nuclear Agency was in substantial compliance with DoD accounting requirements. However, correction of certain deficiencies was essential to produce accurate and auditable financial statements needed to support DoD consolidated statements. The general ledger module contained computer programming errors and omissions; necessary subsidiary records and general ledger accounts had not been established; some recorded account balances were incorrect or insupportable; and general ledger transaction histories were erased at the end of each fiscal year. As a result, the general ledger and supporting information could not be relied on for information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act. The report recommends that Defense Nuclear Agency correct computer logic errors in its financial accounting system, adjust general ledger accounts for incorrect balances, establish necessary subsidiary

*Now the Defense Advanced Research Projects Agency.

ledgers, and retain general ledger transaction histories. The Defense Nuclear Agency concurred with the recommendations and stated that corrective actions would be completed by December 31, 1996.

Inspector General, DoD, Report No. 96-003, "Defense Information Systems Agency FY 1994 General-Purpose Financial Statements," October 5, 1995. The report states that DISA did not use the DoD approved standard general ledger account structure to prepare FY 1994 general-purpose financial statements. Instead, DISA used the budget execution reports as the data source for the financial statements, because DISA personnel had not been trained in the relationship between the general ledger account structure and financial statements and because the DISA management control program was not adequate to ensure that financial statements were prepared using proper sources of information. As a result, DISA FY 1994 financial statements were materially inaccurate and incomplete. The report recommends that DISA use the DoD approved general ledger account structure to prepare future financial statements, train employees assigned to prepare financial statements, and implement adequate management control procedures. The DISA concurred with all recommendations and implemented corrective actions.

The report also states that DISA did not request and the WHS did not make annual general ledger account closing entries to close accounts in the DISA general ledger account structure. The closing entries were not made because WHS and DISA did not clearly define responsibilities for making annual closing entries. As a result, the DISA FY 1995 opening general ledger account structure included materially incorrect balances. The report recommends that the WHS and DISA clarify responsibilities for making general ledger accounting closing entries. The WHS and DISA concurred with the recommendations and took corrective actions.

Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995. The report states that the DFAS DAO/WHS made incorrect or improper payments, improperly certified vouchers, did not update the accounting system, and did not maintain proper supporting documentation. Further, the DFAS DAO/WHS did not adequately use exception reports that identified accounting errors to ensure the integrity of accounting information, did not consistently perform certification of fund availability, and had not implemented a management control program. The report recommends that the Director, DFAS, make improvements in accounting procedures, recoup duplicate payments, maintain adequate source documentation, certify fund availability, and implement a management control program. The Deputy Director for Finance, DFAS, agreed with all recommendations except for requiring that the disbursing officer certify fund availability. Corrective actions taken include validating and recouping duplicate payments; correcting erroneous payments; establishing procedures to minimize duplicate and erroneous payments; and establishing an accounting system training program, uniform filing procedures, and a management control program.

Key Accounting Requirements

The 13 key accounting requirements are included in DoD 7000.14-R, "Financial Management Regulation," volume 1, chapter 3, May 1993. The following is a brief description of each.

KAR 1, General Ledger Control and Financial Reporting. The accounting system must have general ledger control and maintain a DoD approved general ledger account structure for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and financing sources. In addition, full financial disclosure, accountability, adequate financial information, and reports must be provided for management purposes and for necessary external reporting to the Office of Management and Budget and the Department of the Treasury.

KAR 2, Property and Inventory Accounting. The system must account in quantitative and monetary terms for the procurement, receipt, issue, and control of plant, property, equipment, inventory, and material. The property management system must include accounting controls over inventory ledgers that identify the item, its location, quantity, acquisition date, cost, and other information. Subsidiary property records are reconciled periodically to general ledger accounts.

KAR 3, Accounting for Receivables Including Advances. The system must account for all accounts receivable (all debts to the U.S. Government) accurately and promptly to provide timely and reliable financial status.

KAR 4, Cost Accounting. Cost accounting must involve accounting analysis and reporting on costs of production of goods or services or operation of programs, activities, functions, or organizational units. Cost accounting shall be provided in the accounting system if cost accounting is required in such instances as pricing decisions, productivity improvement decisions, or measurement of performance.

KAR 5, Accrual Accounting. Accrual accounting must recognize the accountable aspects of financial transactions or events as they occur. Transactions may be recorded in accounting records as they occur or be adjusted to the accrual basis at each month's end. Unpaid personnel compensation and benefits that have been earned as of the end of the pay year must be accrued in full or in part. Accrued payroll for civilian and military salaries and wages, unfunded annual leave, and annual leave must be recorded and reconciled with the actual payroll.

KAR 6, Military and Civilian Payroll Procedures. Payroll systems must incorporate controls of payroll amounts and payroll deductions to ensure smooth payroll processing action and to minimize incorrect payments. Unpaid personnel compensation and benefits, including annual leave, that have been earned by employees as of the end of the pay year must be accrued in full. Personnel compensation and all employee benefit expenses shall be reported and disclosed in the financial statements.

KAR 7, System Controls (Fund and Internal). The system must ensure that obligations and expenditures do not exceed the amount appropriated. The system must provide a process and procedures for controlling errors. The system must show the appropriations and funds to be accounted for and a description of the accounting entity's proposed fund distribution and control process. The system must have good fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements. The system must have adequate internal controls to prevent, detect, and correct errors and irregularities that occur throughout the system.

KAR 8, Audit Trails. The financial transactions on accounting system processes must be adequately supported with pertinent source documents. Audit trails should allow a transaction to be traced from initiation through processing to final reports.

KAR 9, Cash Procedures and Accounts Payable. The accounting system shall be designed to verify timely payments based on properly approved disbursement documents. Payment procedures must comply with the Prompt Payment Act. Accounts payable should be recorded when goods or services are received.

KAR 10, System Documentation. The accounting system must have adequate system documentation, including documented interfaces between accounting system segments.

KAR 11, System Operations. Accounting system operations shall be adequately planned and organized to assure that financial management and accounting objectives are met in an economical and efficient manner. There should be detailed system operating and maintenance procedures. Also, there should be periodic system reviews to assure that the system is functioning as intended.

KAR 12, User Information Needs. The accounting system must satisfy users' needs of quality, accuracy, timeliness, and reliability to facilitate management's decisionmaking process.

KAR 13, Budgetary Accounting. The accounting system shall support budget formulation and budget requests and shall control budget execution. Programming, budgeting, accounting, reporting, classification, and coding structure should be uniform, mutually consistent, and synchronized with the organizational structure so that actual activity can be compared with enacted budgets to support future budget formulation for each activity.

Management Control Programs

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Management control weaknesses, as defined by DoD Directive 5010.38, existed at the Ballistic Missile Defense Organization, the Defense Advanced Research Projects Agency, the Defense Information Systems Agency, the Defense Mapping Agency, the Defense Nuclear Agency, the Joint Staff, and the Washington Headquarters Services. The weaknesses at each agency are discussed below. To assist in ensuring that Corporate Information Management financial reports were accurate and complete, the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) implemented adequate management controls during the audit.

Adequacy of Management Controls at the Washington Headquarters Services (Report No. 96-194, July 16, 1996). A material management control weakness existed for Washington Headquarters Services (WHS) in that management controls for the WHS Allotment Accounting System were not adequate to ensure that assets were properly reviewed for DoD capitalization criteria before being recorded in the accounting system.

The WHS took action during the audit to properly reclassify as expenses the furniture component assets that did not individually meet the capitalization threshold. The WHS also took action to ensure that future procurement transactions were no longer automatically recorded by the WHS Allotment Accounting System as capital assets.

Adequacy of Management Controls at the Defense Information Systems Agency (Report No. 96-003, October 5, 1995; and Report No. 96-155, June 10, 1996). The DISA did not assess the risk associated with the preparation of general-purpose financial statements and did not establish adequate management control techniques to ensure that general-purpose financial statements were prepared using the DoD approved standard general ledger structure, thereby constituting a material management control weakness. DISA management stated that appropriate management control procedures would be established by the second quarter of FY 1996.

Also, an additional material management control weakness existed in that DISA did not assess the risk associated with the accurate and reliable recording of military equipment transactions and did not establish effective management control techniques to ensure that military equipment assets included in the DISA general ledger were owned by DISA, were properly classified, and were reconciled to official property book records. The DISA has initiated actions to establish appropriate control techniques to ensure that military equipment transactions are accurately recorded in the general ledger and DISA property records.

Adequacy of Management Controls at the Defense Mapping Agency (Report No. 96-088, March 26, 1996). DMA controls over the accuracy of product inventory were not sufficient to ensure the fair presentation of DMA inventory in the financial statements required by the Chief Financial Officers Act, thereby constituting a material management control weakness. Specifically, the DMA did not perform required inventories, and accountable records were inaccurate.

Management at DMA concurred with audit report recommendations and stated that controls or procedures either have been or will be established to correct each identified weakness. Audit recommendations to perform inventories and to revise costing procedures were deferred, however, until the inventory at DMA Philadelphia is relocated and new inventory management and cost accounting systems are implemented. The DMA management partially concurred with the audit assessment that the lack of controls constituted a material management control weakness.

Adequacy of Management Controls at the Joint Staff (Report No. 96-083, March 12, 1996). We identified a material management control weakness in that the Joint Staff had not established adequate management controls related to the maintenance of general ledger accounts used in preparing financial statements. The DFAS DAO/WHS was responsible for preparing the Joint Staff FY 1994 financial statements and had not implemented management control techniques to ensure that the integrity of financial data was maintained, that the data were accurately shown in financial statements, and that financial statements were prepared in accordance with DoD guidance. We discussed with the Chief of the Financial Management Division, Joint Staff, the need for management controls related to maintenance of general ledger accounts used in preparing financial statements. The Chief of the Financial Management Division agreed to initiate a system of monthly reviews of the financial information that will comprise the annual financial statements and an annual review of the Joint Staff financial statements prepared by the DFAS Indianapolis Center.

As a result of our audit, the Joint Staff initiated management controls to ensure the review of and feedback on proprietary information that the DFAS Indianapolis Center will use as the basis for future financial statements.

Adequacy of Management Controls at the Ballistic Missile Defense Organization (Report No. 96-068, February 9, 1996). The Ballistic Missile Defense Organization (BMDO) had a management control weakness in that management controls were lacking over the maintenance of proprietary general ledger accounts and the preparation of financial statements. The DFAS DAO/WHS was responsible for preparing the BMDO FY 1994 financial statements and had not implemented management control techniques to ensure that the integrity of financial data was maintained, that the data were accurately shown in financial statements, and that financial statements were prepared in accordance with DoD guidance. The BMDO did not have sufficient management controls to determine whether the DFAS DAO/WHS was preparing accurate BMDO financial statements. We discussed the need for management controls with the BMDO Deputy Director of the Financial

Management Directorate, who agreed to initiate a system of monthly reviews of the financial information that will comprise the annual financial statements prepared by the DFAS Indianapolis Center.

As a result of our audit, BMDO implemented management controls to ensure review and feedback on the proprietary information used as the basis for future financial statements.

Adequacy of Management Controls at the Defense Advanced Research Projects Agency (Report No. 96-048, December 19, 1995). The DAO/WHS was responsible for preparing the Defense Advanced Research Projects Agency FY 1994 financial statements. The DFAS DAO/WHS had not implemented management control techniques to ensure that the integrity of financial data was maintained, that the data were accurately shown in financial reports, and that financial statements were prepared in accordance with DoD guidance, thereby constituting a material management control weakness.

The DFAS management stated that the Denver Center will implement a management control program for the DFAS DAO/WHS and will include the results of the program in the DFAS Denver Center FY 1996 Annual Statement of Assurance. In April 1996, responsibility for the DFAS DAO/WHS transferred to the DFAS Indianapolis Center. The DFAS Denver Center and the DFAS Indianapolis Center planned to establish a memorandum of understanding related to implementing appropriate corrective action.

Adequacy of Management Controls for Corporate Information Management Financial Reports (Report No. 96-042, December 11, 1995). In FY 1994, the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) [OASD(C^3I)] did not have oversight of Corporate Information Management (CIM) funds suballocated to the Defense Information Systems Agency and the Military Departments because each suballocation was accounted for in a separate accounting system. In FY 1995, the OASD(C^3I) implemented procedures to provide complete oversight of CIM funds. Specifically, the OASD(C^3I) established only one suballocation of the FY 1995 CIM allocation, thereby correcting the lack of oversight that existed in FY 1994 for CIM allocations.

The action taken by the OASD(C^3I) to gain improved oversight of CIM fund outlays result in more complete financial statements. The OASD(C^3I) action provides an excellent example of how good management controls assist in ensuring that financial statements are accurate and complete.

Adequacy of Management Controls at the Defense Nuclear Agency (Report No. 96-039, December 11, 1995). The Defense Nuclear Agency (DNA) used the Centralized Accounting and Financial Resource Management System to perform accounting, financial reporting, budgeting, and planning functions. The Centralized Accounting and Financial Resource Management System had built-in controls to ensure that transactions could be traced and that the person responsible for input of transactions could be identified. However, adequate subsidiary records were not established, general ledger transaction histories were not retained, and procedures were not established to verify balances shown in the general ledger. Therefore, management controls were not fully effective to assure the reliability and auditability of financial information produced by the general ledger in the Centralized Accounting and Financial Resource Management System. In addition, management had not performed vulnerability risk assessments during FYs 1993 and 1994 as scheduled in the DNA 5-year Management Control Plan. The DNA did not perform the assessments because it was reidentifying its assessable units to coincide with changes in the DNA mission.

Material management control weaknesses existed for DNA in that controls over recording, reconciling, and reporting capitalized equipment in use by DNA and Government-owned property held by DNA contractors were not adequate to ensure accurate and supportable financial statements.

As part of its FY 1994 Annual Statement of Assurance, DNA correctly reported as a material weakness that capitalized equipment had not been reconciled to general ledger accounts. The Annual Statement of Assurance showed that DNA planned completion of corrective action by March 1996. The DNA was also awaiting guidance from DoD on proper procedures for recording DNA property held by contractors.

The DNA concurred with the audit recommendations to improve management control of equipment and has initiated corrective actions.

General Ledger Control and Financial Reporting Weaknesses

General ledger and financial reporting material weaknesses existed at the accounting offices that support the Defense Advanced Research Projects Agency (DARPA) and the Defense Logistics Agency. Material weaknesses also existed at the Defense Information Systems Agency (DISA) and the Defense Nuclear Agency (DNA). The OASD(C3I) corrected a material general ledger and financial reporting weakness for CIM funds during the audit.

We identified other general ledger and financial reporting weaknesses at the accounting offices that support the American Forces Information Service, the BMDO, and the Joint Staff; and at the Department of Defense Education Activity, the DMA, the On-Site Inspection Agency, the Office of Civilian Health and Medical Program of the Uniformed Services (OCHAMPUS), and the Uniformed Services University of the Health Sciences.

General Ledger and Financial Reporting Material Weaknesses

Defense Advanced Research Projects Agency. The FY 1994 DARPA financial statements, prepared by the DFAS DAO/WHS, were inaccurate and incomplete. Instead of using proprietary general ledger account information, the DFAS DAO/WHS inappropriately used budget execution reports as the data source to prepare FY 1994 DARPA financial statements. In addition, the DFAS DAO/WHS methodology for preparing FY 1994 financial statement reports was flawed. Incorrect sources of information were used because DFAS DAO/WHS personnel had not been trained in financial statement preparation and because DFAS DAO/WHS did not have management controls in place to ensure that proper sources of information were used to prepare financial statements or that financial statements were reviewed to ensure their accuracy and reliability. As a result, the FY 1994 consolidated financial statements for DARPA were materially inaccurate and unreliable. The statements overstated DARPA assets by $2.2 billion, liabilities by $25 million, and equity by $2.3 billion.

Defense Information Systems Agency. The DISA did not use the DoD approved standard general ledger account structure to prepare FY 1994 general-purpose financial statements. Rather than properly use the standard general ledger account structure, DISA used budget execution reports as the data source for the financial statements. Also, DISA personnel had not been trained in the relationship between the general ledger account structure and financial statements, and the DISA management control program was not adequate to ensure that financial statements were prepared using proper sources of information. As a result, DISA FY 1994 general-purpose financial statements were materially incomplete and inaccurate. The statements omitted military equipment assets of about $495 million; omitted liabilities of $12 million for annual leave benefits earned, but not paid to employees; misclassified liabilities of about $3.3 million for payroll and related benefits earned, but not paid to employees; included an arbitrary and unsupported allocation of $199.2 million in accounts payable to the public and to other Government agencies; and overstated operating expenses by about $63 million.

In addition, the DISA did not request and the WHS did not make annual general ledger account closing entries to close accounts in the DISA general ledger account structure. The closing entries were not made because WHS and DISA did not clearly define responsibilities for making annual closing entries. As a result, the DISA FY 1995 opening general ledger account structure included materially incorrect account balances. Account balances were overstated by $2.6 billion for the asset account series, $2.3 billion for the equity account series, $368 million for the revenue account series, and $2.6 billion for the expense account series.

Defense Logistics Agency. The Defense Business Management System is the accounting system used to record, analyze, process, and report Defense Logistics Agency general fund transactions. The general ledger chart of accounts in the Defense Business Management System did not agree with the uniform Federal and DoD chart of accounts. Accounting personnel at DFAS, Columbus, Ohio, performed a "crosswalk"* at the end of the accounting period for each general ledger account before financial statements were prepared. However, the DFAS personnel did not follow established standard operating procedures to perform the crosswalks.

In addition, the FY 1994 financial statements, which DFAS, Columbus, Ohio, prepared for the Defense Logistics Agency general fund, were unreliable. The trial balances used to prepare the financial statements inappropriately contained data for operating activities that were not funded with Defense Logistics Agency general funds. Also, Defense Business Operations Fund accounts were improperly included in the general fund trial balance.

Defense Nuclear Agency. The DNA uses the Centralized Accounting and Financial Resource Management System (CAFRMS) to perform accounting, financial reporting, budgeting, and planning functions. The general ledger module of CAFRMS contained computer programming errors and omissions; DNA did not establish necessary subsidiary records; some recorded account balances were incorrect or insupportable; and the general ledger module of CAFRMS was erased after the end of each fiscal year, preventing easy access to transactions supporting general ledger balances. These conditions occurred because DNA had not established management controls to ensure the accuracy and supportability of general ledger proprietary accounts. As a result, the general ledger and supporting information could not be relied on for information necessary to produce auditable and accurate financial statements required by the Chief Financial Officers Act.

*The process that transmits financial data from the accounts in the Defense Logistics Agency general ledger to appropriate accounts in the Uniform Chart of Accounts in the DoD standard general ledger.

The financial accounting system DNA used was in substantial compliance with DoD accounting requirements. However, correction of certain deficiencies was essential to produce accurate and auditable financial statements needed to support DoD consolidated statements. The Director, DNA, concurred with the audit report (Report No. 96-039) recommendations and initiated actions to correct the deficiencies.

Corporate Information Management. The FY 1994 CIM trial balance, prepared by WHS, omitted CIM funds that the OASD(C^3I) suballocated to DISA and the Military Departments. The CIM trial balance is a document of the financial transactions from the CIM Central Fund and is used by the OASD(C^3I) as the basis for preparing required financial statements. In FY 1994, the DISA and Military Departments represented about 20 percent of the total FY 1994 CIM allocation. The FY 1994 CIM trial balance included only the financial statement transactions from the CIM Central Fund, a suballocation of CIM funds managed directly by the OASD(C^3I). The OASD(C^3I) did not have oversight of CIM funds allocated to DISA and the Military Departments because each suballocation was accounted for in a separate accounting system.

During the audit, the OASD(C^3I) implemented procedures to ensure that all CIM funds allocations were reported in the FY 1995 CIM trial balance. Specifically, in FY 1995, the OASD(C^3I) decided to distribute CIM funds to DISA and the Military Departments as reimbursable work orders from the CIM Central Fund suballocation. Distributing CIM funds on reimbursable funding documents rather than suballocating CIM funds resulted in the entire CIM allocation remaining in a single accounting system, the WHS Allotment Accounting System. That system can produce general ledger based trial balances that can be used to create required financial statements. The actions taken by the OASD(C^3I) to gain improved oversight of CIM fund outlays result in more accurate financial statements.

Other General Ledger and Financial Reporting Weaknesses

American Forces Information Service. The WHS prepared the FY 1994 American Forces Information Service financial statements. The WHS personnel prepared the financial statements from proprietary general ledger data maintained in the WHS Allotment Accounting System and from budget data that represented American Forces Information Service financial data maintained by others. Approximately 33 percent of American Forces Information Service financial data was inappropriately "crosswalked" to the FY 1994 financial statements from budget execution reports.

We did not perform audit tests to determine the materiality of financial statement reporting errors related to the use of budget data sources for financial statement preparation. However, Office of the Inspector General, DoD, Report No. 96-003, "Defense Information Systems Agency FY 1994 General-Purpose Financial Statements," October 5, 1995, states that budget execution reports do not contain needed information to prepare complete and accurate financial statements.

Ballistic Missile Defense Organization. The FY 1994 BMDO financial statements, prepared by the DFAS DAO/WHS, were inaccurate and incomplete. The DFAS DAO/WHS reported BMDO Research, Development, Test, and Evaluation funds to the DFAS Indianapolis Center on two separate financial statements, resulting in overstatements of BMDO asset, liability, and equity accounts. In addition, the DFAS DAO/WHS used budgetary information from budget execution reports instead of using proprietary general ledger account information to prepare FY 1994 financial statements for the BMDO. Budget execution reports did not contain needed information to prepare complete and accurate FY 1994 financial statements. We identified errors and omissions, totaling about $1.9 billion, in 12 financial statement accounts.

Defense Mapping Agency. The DMA does not maintain automated general ledger accounts. The DFAS performed an evaluation of the accounting system in 1995 and acknowledged that due to the lack of a transaction driven general ledger, the system did not comply with General Accounting Office approved accounting principles, standards, and related requirements. The DMA staff maintained a manual general ledger, which consisted of folders in a file cabinet. Also, the DMA staff made no closing entries to the general ledger and established no projected date for a general ledger accounting system to be in place.

Department of Defense Education Activity. The Department of Defense Education Activity did not use a transaction-based general ledger accounting system capable of producing financial statements in accordance with the Chief Financial Officers Act of 1990.

Joint Staff. The FY 1994 Joint Staff financial statements, prepared by DFAS DAO/WHS, were inaccurate. The DFAS DAO/WHS reported Research, Development, Test, and Evaluation funds that had been appropriated to the Joint Staff on two separate financial statements and submitted them to the DFAS Indianapolis Center. That action resulted in Joint Staff asset account overstatements of about $48 million. In addition, the DFAS DAO/WHS used budgetary information from budget execution reports instead of using proprietary general ledger account information to prepare FY 1994 financial statements for the Joint Staff. Budget execution reports did not contain needed information to prepare complete and accurate FY 1994 financial statements.

Office of the Civilian Health and Medical Program of the Uniformed Services. The Resource Accounting Management System is the accounting system OCHAMPUS uses to record and report financial information. General ledger accounts, although in use, had irregular balances. Accounting and finance personnel did not document the rationale for or the sources of the adjustments made to FY 1994 accounting data generated by the Resource Accounting Management System.

The OCHAMPUS documentation did not support the FY 1994 financial statement trial balance or the accounting system balances. Also, the trial balances and the accounting system excluded accruals for direct and reimbursable expenses. In addition, the trial balance and accounting system erroneously classified and recorded Military Interdepartmental Purchase Requests and preclosing entries.

The OCHAMPUS did not record direct expenses for Accounts Payable-Government and Accounts Payable-Public. The OCHAMPUS personnel stated that they did not have time to record accounts payable for direct expenses. Because the accounts payables were not recorded, the related expense accounts were not debited until funds were disbursed. As a result, financial reports understated accounts payables and expenses.

On-Site Inspection Agency. The On-Site Inspection Agency used the CAFRMS to perform its general ledger accounting and financial reporting functions. The CAFRMS had not been programmed to produce a consolidated general ledger of all appropriations. Other deficiencies summarized below and mentioned in Report No. 96-039, "Financial Accounting for the Defense Nuclear Agency," December 11, 1995, may also be applicable because the On-Site Inspection Agency uses the CAFRMS. Deficiencies discussed in the report follow.

o The general ledger module of CAFRMS contained computer programming errors and omissions.

o The general ledger module of CAFRMS was erased after the end of each fiscal year, preventing easy access to transactions supporting general ledger balances.

o Necessary subsidiary records for accounts receivable and payable, and plant, property, and equipment were not established in CAFRMS.

Uniformed Services University of the Health Sciences. The Uniformed Services University of the Health Sciences uses the College and University Financial System for financial management. In the "System Manager/User Review for Operational Systems-FY 1994," the Internal Control and Audit Directorate, DFAS headquarters, stated that the College and University Financial System did not have adequate subsidiary ledgers to support accounts payable, advances, accounts receivable, and unearned revenues control accounts.

Property and Inventory Accounting Weaknesses

We identified material property and inventory accounting weaknesses at the DISA, the Defense Logistics Agency, the DMA, the DNA, the Department of Defense Education Activity, and the WHS.

We identified other property and inventory accounting weaknesses at the Defense Technology Security Administration and at OCHAMPUS.

Material Property and Inventory Accounting Weaknesses

Defense Information Systems Agency. The DISA military equipment general ledger asset account was significantly overstated. The overstatements occurred because DISA did not analyze financial transactions needed to make appropriate accounting entries to:

o support the transfer of equipment ownership to other DoD Components;

o classify properly the equipment loans to other DoD Components, other Federal agencies, and contractors;

o classify properly the computer software acquisitions; and,

o expense acquisitions of nonmilitary equipment items and military equipment that did not meet DoD asset capitalization thresholds.

As a result, DISA overstated the military equipment in use account by about $93.7 million and misstated the following general ledger accounts:

o overstated appropriated capital by about $43.5 million;

o understated military equipment loans to other DoD Components by about $5.4 million;

o understated military equipment furnished to other Federal agencies, DoD contractors, and others by about $37.2 million;

o understated computer software acquisitions by about $7.2 million; and

o understated non-capitalized military equipment acquisitions and other expense accounts by about $0.4 million.

In February 1996, DISA initiated actions to correct a $41 million overstatement of military equipment. The Inspector General, DISA, concluded that the military equipment acquisitions were properly recorded on the general ledger of the Defense Information Technology Contracting Office, a Defense Business Operations Fund field unit under DISA. The Inspector General, DISA, therefore, advised the DISA Comptroller to make appropriate accounting entries to remove the $41 million in military equipment assets from the DISA appropriated fund general ledger.

Defense Logistics Agency. The Defense Business Management System did not maintain data on individual fixed assets or property. The $411 million Defense Logistics Agency general fund property account was not supportable because the data were based on both Defense Business Operations Fund and general fund activities. The risk of misstatement was high because the Defense Logistics Agency included Defense Business Operations Fund activities in the general fund trial balances. Also, the Defense Logistics Agency did not capitalize assets that met DoD capitalization thresholds. Further, physical assets and financial statements were not reconcilable.

Defense Mapping Agency. Fixed assets the DMA reported for FY 1994 were understated because the Air Force Standard Base Supply System was not able to capture items valued at more than $999,999.99. Also, the physical count of DMA inventory differed from the quantities in accounting records, unit costs of DMA products were incorrect and lacking supporting documentation, and inventory on hand exceeded usage history.

In addition, DMA inventory accounting procedures were not effective, and DMA did not perform required periodic inventories. About 83 percent of the recorded inventory balances at DMA Philadelphia was incorrect, and accounting records could not be relied on to produce accurate financial statements.

In June 1995, DMA made a programming change to the Air Force Standard Base Supply System to capture items valued at more than $999,999.99.

Defense Nuclear Agency. The DNA had not reconciled inventories of its capital assets to general ledger control accounts. The FY 1994 Annual Statement of Assurance stated that the full implementation of corrective action is dependent on Office of the Secretary of Defense guidance. However, DNA stated that it will reconcile the general ledger capital equipment accounts to the appropriate local property books by March 1996.

Department of Defense Education Activity. The Department of Defense Education Activity was unable to provide reliable asset valuation information. The Department of Defense Education Activity maintains its official property record on the Dependents Schools Automated Material Management System. That system did not maintain reliable purchase dates for assets transferred from one location to another because the original purchase dates were replaced with the subsequent dates of transfer. Therefore, the Department of Defense Education Activity was unable to properly age its assets.

The Department of Defense Education Activity did not have adequate controls over assets because Department of Defense Education Activity officials did not establish procedures to ensure that property records were accurate, promptly recorded, consistent, and complete. Department of Defense Education Activity officials could not explain reasons for significant asset losses and did not reconcile property records to the financial system to ensure accuracy.

Washington Headquarters Services. The FY 1994 WHS military equipment general ledger asset account was significantly overstated. The overstatement occurred because WHS did not adequately analyze military equipment procurement transactions to determine whether procured equipment should have been capitalized or expensed. As a result, the WHS overstated FY 1994 general ledger asset and equity accounts by at least $16.3 million. That amount may be larger because WHS did not adequately analyze whether the $223.6 million of military equipment reported by WHS on its FY 1994 trial balance should have been capitalized.

In April 1996, the WHS initiated actions to reclassify $9.5 million for furniture procurements as an expense rather than as military equipment because the furniture components did not individually meet the capitalization threshold. The WHS Budget and Finance Manager agreed that the capitalization criteria for all military equipment transactions subclassified as office furniture, furnishings, and fixtures should be based on unit cost. Therefore, the WHS Budget and Finance Manager took actions to review all office furniture, furnishings, and fixtures transactions within the WHS military equipment account and to expense those transactions with unit costs that did not meet DoD capitalization criteria. The WHS Budget and Finance Manager also took action to ensure that office furniture, furnishings, and fixtures transactions are no longer automatically recorded by the WHS Allotment Accounting System as capital assets.

Other Property and Inventory Accounting Weaknesses

Defense Technology Security Administration. The Defense Technology Security Administration was not sure what was included in its $7.2 million FY 1994 military equipment account balance. Defense Technology Security Administration personnel believed the balance consisted of all furniture and computer equipment purchased since the agency's inception. Although the Defense Technology Security Administration maintained a list of computer equipment and software, the list did not include unit prices of the computer equipment or software.

Office of Civilian Health and Medical Program of the Uniformed Services. The OCHAMPUS reported approximately $2.7 million in the Automated Data Processing Software account on the FY 1994 trial balance. However, only $2.3 million in automated data processing equipment was identified in the property records maintained by OCHAMPUS. The $400,000 difference was due to automated data processing equipment that was disposed of, but not removed from the accounting records. Misstating asset values on the trial balance affects the reliability of the organization's overall position shown in the financial statements.

Weaknesses in System Controls (Fund and Internal)

We identified material weaknesses related to fund controls and accounting system internal controls at the BMDO, DARPA, DISA, DMA, the Department of Defense Education Activity, and the Joint Staff.

We identified other fund and internal control weaknesses at the Defense Contract Audit Agency, the OCHAMPUS, and the Uniformed Services University of the Health Sciences.

Material Weaknesses in System Controls (Fund and Internal)

Ballistic Missile Defense Organization. The DFAS DAO/WHS did not provide supervision and other internal controls needed to ensure the accurate preparation of BMDO financial statements. The DFAS DAO/WHS did not have a system of review for financial reporting and did not detect errors made by accountants in preparing SF 220, "Report on Financial Position," reports for agency consolidation with other Defense agencies. In addition, the DFAS DAO/WHS did not have adequate fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements.

The BMDO did not have sufficient internal controls to determine whether the DFAS DAO/WHS prepared the FY 1994 financial statements and whether the statements were accurate.

Defense Advanced Research Projects Agency. The DFAS DAO/WHS did not maintain control over the integrity of DARPA FY 1994 financial reports. The DFAS DAO/WHS inappropriately used budget execution reports in its "crosswalk" methods to prepare financial statements. In addition, the DFAS DAO/WHS methodology for preparing FY 1994 financial statement reports did not include supervisory controls or review procedures. Further, the DFAS DAO/WHS had no controls in place to ensure that personnel were properly trained to prepare financial statements.

Defense Information Systems Agency. The DISA did not assess the risk associated with the preparation of general-purpose financial statements and, therefore, did not establish effective accounting controls concerning the use and maintenance of general ledger accounts and the accuracy and classification of property transactions.

The DISA did not adequately establish management controls to ensure the analysis of military equipment financial transactions before the financial transactions were recorded in the general ledger. The DISA analyzed military equipment transactions according to DoD object classification codes; however, those codes were intended and are used for budgetary, not proprietary accounting purposes. The codes did not provide information on asset ownership, asset location, and asset status as required by the DoD standard general ledger.

Defense Mapping Agency. The DMA did not have internal controls in place to ensure that property and inventory balances were accurately represented on the FY 1994 financial statements. Specifically, the DMA did not perform required inventories, and required accounting records were inaccurate.

Department of Defense Education Activity. The Department of Defense Education Activity internal control environment did not provide reasonable assurance that revenues and expenditures were properly reported and accounted for and that the Department of Defense Education Activity maintained proper accountability over its assets. Therefore, the Department of Defense Education Activity could not provide reasonable assurance that the financial reports were reliable.

Joint Staff. The DFAS DAO/WHS did not provide supervision or a system of review for financial reporting and did not detect errors made by accountants in preparing SF 220 reports. In addition, disbursements exceeded the funds committed to several document accounts; the overdisbursement of funds within document accounts indicated a lack of funds control and could lead to a potential violation of the Antideficiency Act.

The DFAS DAO/WHS personnel did not receive adequate training to prepare financial statements and were unaware of the requirements of the laws and regulations that apply to the preparation of the statements. As a result, the DFAS DAO/WHS operating accountant prepared the SF 220 report inappropriately using budgetary information rather than proprietary information.

The DFAS DAO/WHS used an accounting system that did not have adequate fund control procedures to prevent untimely liquidation of obligations, unmatched expenditures, and undistributed disbursements. Not all entries were posted in a timely manner, and detected errors remained uncorrected at the end of the fiscal year.

Other Weaknesses in System Controls (Fund and Internal)

Defense Contract Audit Agency. The Defense Contract Audit Agency did not establish internal accounting policies and procedures manuals or written accounting policies and procedures.

Office of Civilian Health and Medical Program of the Uniformed Services. The OCHAMPUS finance and accounting staff did not maintain records to show how they derived the FY 1994 trial balance data submitted to DFAS. General ledger account balances reported on the trial balance did not reconcile to the data maintained on the OCHAMPUS automated records. The OCHAMPUS staff stated that they made adjustments when they knew the automated system data could not be relied on.

Uniformed Services University of the Health Sciences. Because the University finance and accounting staff did not maintain subsidiary ledgers for several key control accounts, the staff could not perform monthly reconciliations to the general ledger control accounts. Management stated that they will begin maintaining subsidiary ledgers during FY 1997, when implementation of the Federal Financial System is completed.

Audit Trail Weaknesses

We identified material weaknesses related to KAR 8, Audit Trails, at the accounting offices that support the BMDO, the DARPA, the Defense Legal Services Agency, the Defense Medical Programs Activity, and the Joint Staff; and at the Department of Defense Education Activity. Audit trails should allow a transaction to be traced from initiation through processing to final reports.

We identified other audit trail weaknesses at the accounting office that supports the American Forces Information Service.

Material Audit Trail Weaknesses

Ballistic Missile Defense Organization. The DFAS DAO/WHS could not provide supporting documentation for transactions involving BMDO financial statement accounts. The DFAS DAO/WHS did not properly maintain source documents and files, and the audit trails maintained by DFAS DAO/WHS were deficient to support BMDO transactions. In addition, entire document files and individual documents were missing from supporting documentation account files.

Defense Advanced Research Projects Agency. The DFAS DAO/WHS performed the installation accounting function for DARPA and demonstrated poor audit trail maintenance. Although we did not review audit trail documents for DARPA, this DFAS DAO/WHS deficiency is documented in Office of the Inspector General, DoD, Report No. 95-231, "Vendor Payments-Defense Accounting Office, Air Force District of Washington, Finance Washington," June 12, 1995.

Defense Legal Services Agency. The DFAS DAO/WHS performed the installation accounting function for the Defense Legal Services Agency and did not maintain sufficient audit trail documentation. Although we did not review supporting documents for the Defense Legal Services Agency, this DFAS DAO/WHS deficiency is also documented in Office of the Inspector General, DoD, Report No. 95-231.

Defense Medical Programs Activity. The DFAS DAO/WHS performed the installation accounting function for the Defense Medical Programs Activity, but did not maintain sufficient audit trail documentation. Although we did not review supporting documents for the Defense Medical Programs Activity, this DFAS DAO/WHS deficiency is documented in Office of the Inspector General, DoD, Report No. 95-231.

Department of Defense Education Activity. The Department of Defense Education Activity did not have adequate audit trails because documentary support for transactions was not comprehensive or readily available.

Joint Staff. The DFAS DAO/WHS was unable to provide the necessary documentation to support detailed transaction listings. Entire document files were missing for Joint Staff transactions. In addition, source documents to support posted transactions were missing from document files.

Other Audit Trail Weaknesses

American Forces Information Service. The DFAS DAO/WHS performed the installation accounting function for the American Forces Information Service Headquarters and did not maintain auditable files. We did not review supporting documents for the American Forces Information Service, but this DFAS DAO/WHS deficiency is documented in Office of the Inspector General, DoD, Report No. 95-231.

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Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Advanced Research Projects Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Information Systems Agency
Director, Defense Legal Services Agency
Director, Defense Logistics Agency

Other Defense Organizations (Cont'd)

Director, Defense Special Weapons Agency
Director, National Imagery and Mapping Agency
Director, National Security Agency
  Inspector General, National Security Agency
Director, On-Site Inspection Agency
Director, American Forces Information Service
Director, Defense Technology Security Administration
Director, Department of Defense Education Activity
Director, Office of Civilian Health and Medical Program of the Uniformed Services
Director, Washington Headquarters Services
Inspector General, Defense Intelligence Agency
President, Uniformed Services University of the Health Sciences

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairmen and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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